

08-1425-cv
Interworks Sys. Inc. v. Merchant Fin. Corp.

1 UNITED STATES COURT OF APPEALS

2 FOR THE SECOND CIRCUIT

3 August Term, 2008

4 (Argued : June 3, 2009

Decided: May 14, 2010)

5 Docket No. 08-1425-cv

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7 INTERWORKS SYSTEMS INC., Debtor and Debtor-In-Possession,
8 Individually and as Trustee for all Trust Beneficiaries under
9 Article 3-A of the New York Lien Law,

10 Plaintiff,

11 UNITED STATES OF AMERICA,

12 Intervenor-Plaintiff-Appellant,

13 - v -

14 MERCHANT FINANCIAL CORPORATION,

15 Defendant-Cross-Defendant-Appellee,

16 COLONIAL SURETY COMPANY,

17 Cross-Claimant-Appellee.

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19 Before: McLAUGHLIN, CALABRESI, and SACK, Circuit Judges.

20 Appeal from a judgment of the United States District
21 Court for the Eastern District of New York (Nina Gershon, Judge).
22 The court dismissed a complaint-in-intervention by the United
23 States seeking unpaid employment taxes from the defendant,
24 Merchant Financial Corporation, under New York Lien Law §§ 70-
25 79a, customarily referred to as "Article 3-A," on the ground that
26 the United States had not complied with, and was not excused from

1 compliance with, two procedural requirements provided by Article
2 3-A. We conclude that at least the first of these procedural
3 requirements, that there be no prior pending Article 3-A action,
4 applies to the United States when it brings an action under
5 Article 3-A. We therefore need not and do not address the other
6 Article 3-A requirement.

7 Affirmed.

8 ANDREA R. TEBBETS (Kenneth W. Rosenberg,
9 Attorney, Tax Division, Department of
10 Justice, Benton J. Campbell, United
11 States Attorney, Eastern District of New
12 York, of counsel), for Nathan J.
13 Hochman, Assistant Attorney General, Tax
14 Division, Department of Justice,
15 Washington, DC, for Intervenor-
16 Plaintiff-Appellant.

17 TAB ROSENFELD, Rosenfeld & Kaplan, New
18 York, NY, for Defendant-Cross-Defendant-
19 Appellee.

20 ROBERT W. McCANN (Richard J. Allen, Jr.,
21 of counsel) Klotz & McCann, New York,
22 NY, for Cross-Claimant-Appellee.

23 SACK, Circuit Judge:

24 The United States appeals from a January 30, 2008,
25 judgment of the United States District Court for the Eastern
26 District of New York (Nina Gershon, Judge). The district court
27 dismissed the United States' complaint-in-intervention in an
28 action brought by Interworks Systems, Inc. ("Interworks") against
29 Merchant Financial Corporation ("Merchant"). The underlying
30 action by Interworks, originally filed in the Southern District
31 of New York and later transferred to the Eastern District of New
32 York, sought to recover funds that Merchant had allegedly

1 diverted in violation of New York Lien Law §§ 70-79a ("Article 3-
2 A"). In the complaint-in-intervention, the United States alleged
3 that Merchant, through its first priority lien on all of
4 Interworks' accounts receivable, had received and improperly
5 diverted Article 3-A trust funds that had been paid to Interworks
6 pursuant to certain public works contracts, and was therefore
7 liable to the United States for Interworks' unpaid federal
8 employment taxes related to work stemming from those contracts.

9 The district court dismissed the complaint-in-
10 intervention on the ground that the government had not complied
11 with, and was not excused from compliance with, two separate
12 procedural requirements for bringing an action under Article 3-A:
13 (1) that there be no prior pending Article 3-A action, and (2)
14 that the Article 3-A suit be brought in a representative capacity
15 on behalf of all other beneficiaries of the Article 3-A trust.
16 Interworks Sys., Inc. v. Merchant Fin. Corp., 531 F. Supp. 2d
17 478, 482 (E.D.N.Y. 2008). On appeal, the government does not
18 dispute that it failed to meet these requirements. It argues
19 instead that Article 3-A's procedural requirements do not apply
20 to the United States and that, even if they did, the United
21 States' power to enforce federal tax law in federal court either
22 excuses it from compliance with or preempts these requirements.

23 We agree with the district court that where the United
24 States brings an action pursuant to Article 3-A, it is bound by
25 Article 3-A's procedural requirement that there be no prior
26 pending action. Inasmuch as this conclusion provides a

1 sufficient basis for us to affirm the judgment of the district
2 court, we do not reach the question of whether the United States
3 should be excused from compliance or allowed to amend its
4 complaint so as to allege compliance with Article 3-A's
5 representative capacity requirement.

6 **BACKGROUND**

7 This case arises out of several public-works
8 improvement contracts entered into by Interworks, a New York
9 corporation in the business of selling, installing, and servicing
10 private telephone switchboard systems and large voice/data
11 structured cabling systems, to provide data and cabling services
12 to customers in the greater New York metropolitan area, and the
13 relationship of those contracts to New York Lien Law §§ 70-79a,
14 generally known as "Article 3-A." The dispute in this case does
15 not concern the rights of any of the direct parties to the data
16 and cabling contracts themselves. Instead, at issue here are the
17 rights of three other parties: (1) Colonial Surety Company
18 ("Colonial"), the company that acted as a surety for Interworks
19 in the data and cabling contracts; (2) Merchant, the company that
20 provided financing to Interworks in relation to the data and
21 cabling, as well as other, contracts; and (3) the United States
22 government, which alleges an interest in unpaid employment taxes
23 stemming from the data and cabling contracts. It is the
24 respective rights of these three parties under Article 3-A that
25 we are faced with here.

26 Article 3-A

1 Article 3-A is a New York State statute designed to
2 protect subcontractors, tax collectors, and parties who expend
3 labor or extend financing in construction projects, by impressing
4 with a trust any funds paid to a contractor or received by an
5 owner in connection with an improvement of real property in the
6 state. See Aspro Mech. Contracting, Inc. v. Fleet Bank, N.A., 1
7 N.Y.3d 324, 328, 805 N.E.2d 1037, 1039, 773 N.Y.S.2d 735, 737
8 (2004) ("Article 3-A of the Lien Law creates trust funds out of
9 certain construction payments or funds to assure payment of
10 subcontractors, suppliers, architects, engineers, laborers, as
11 well as specified taxes and expenses of construction.") (internal
12 citations and quotation marks omitted); LeChase Data/Telecom
13 Servs., LLC v. Goebert, 6 N.Y.3d 281, 289, 844 N.E.2d 771, 776,
14 811 N.Y.S.2d 317, 322 (2006) ("[T]he primary purpose of article
15 3-A and its predecessors is to ensure that those who have
16 directly expended labor and materials to improve real property or
17 a public improvement at the direction of the owner or a general
18 contractor receive payment for the work actually performed")
19 (internal citation and quotation marks omitted, alterations
20 incorporated).

21 An Article 3-A trust arises automatically by operation
22 of law when fees are paid to the contractor or received by the
23 owner in connection with an improvement of real property. N.Y.
24 Lien Law § 71.5. Until all trust fund beneficiaries have been
25 satisfied, it is an unlawful diversion of trust fund assets for
26 the contractor or owner to use any of the trust fund assets for

1 any purpose other than satisfying the claims of beneficiaries.
2 See id. § 72.1; LeChase, 6 N.Y.3d at 289. If the contractor or
3 owner unlawfully diverts the trust assets before a trust
4 beneficiary is satisfied, that beneficiary may recover the trust
5 assets from anyone who has received the assets with knowledge of
6 their trust status. See N.Y. Lien Law §§ 77.1, 77.3(6); LeChase,
7 6 N.Y.3d at 289. The beneficiaries of the trust may be, among
8 others, subcontractors, architects, engineers, surveyors,
9 laborers, materialmen, tax authorities, and persons providing
10 surety bonds. N.Y. Lien Law § 71.2.

11 It is undisputed that the funds paid to Interworks in
12 connection with the public improvement contracts for data and
13 cabling services at issue in this case were Article 3-A trust
14 assets.

15 The Financing and Surety Contracts

16 Interworks entered into two related contracts in
17 connection with the data and cabling services contracts that
18 provide the basis for the underlying lawsuit in this case: One
19 provided for financing of the data and cabling services
20 contracts, and one provided a surety should Interworks prove
21 unable to perform its obligations under those contracts.

22 In order to obtain financing, Interworks entered into a
23 security agreement with Merchant on February 23, 2001 under the
24 terms of which Merchant promised to lend Interworks money¹ in

¹ Merchant agreed to loan or advance to Interworks the lesser of (1) \$4,000,000 or (2) the sum of 80 percent of

1 return for a first priority lien on substantially all of
2 Interworks' personal property, including all accounts
3 receivables. As a result, all instruments representing payments
4 under the data and cabling contracts were made out to Interworks
5 but sent directly to Merchant. Interworks alleges that Merchant
6 received at least \$1,000,000 in its capacity as a lien holder
7 over its accounts receivable.

8 New York law generally requires a contractor like
9 Interworks to enter into a surety agreement to ensure completion
10 of its contracts. See Titan Indem. Co. v. Triborough Bridge and
11 Tunnel Auth., Inc., 135 F.3d 831, 834 (2d Cir. 1998). To meet
12 this obligation, Interworks contracted with Colonial to act as a
13 surety on its public improvement contracts, pursuant to which
14 Colonial would issue performance and payment bonds for the public
15 improvement contracts.

16 The United States' Interest in This Litigation

17 Interworks failed to pay federal employment taxes in
18 connection with both the public improvement contracts that are
19 the subject of this litigation and other contracts. On August 2,
20 2002, the Internal Revenue Service ("IRS") filed a tax lien
21 against Interworks in the amount of \$686,403.18. The government
22 later estimated Interworks' tax obligations to total
23 \$1,874,971.20, at least \$557,129.29 of which allegedly arose out
24 of public improvement contracts for which Merchant had provided

Interworks' accounts receivables plus 50 percent of Interworks'
inventory.

1 financing to Interworks in return for a first priority lien on
2 Interworks' accounts receivable and other property.

3 Colonial's State-Court Lawsuit

4 On July 7, 2003, Interworks and two of its affiliates
5 filed petitions for relief pursuant to Chapter 11 of the
6 Bankruptcy Code with the United States Bankruptcy Court for the
7 Eastern District of New York. Because Interworks was unable to
8 complete performance of its public improvement contracts,
9 Colonial, pursuant to the surety agreement, made payments to sub-
10 contractors and fulfilled Interworks' other obligations under the
11 public improvement contracts. Between Interworks' debts to
12 subcontractors, suppliers, and laborers, and Interworks' federal
13 and state tax obligations for which Colonial, as surety, is
14 potentially liable, Colonial allegedly incurred financial
15 obligations of \$1,750,076.90 and suffered claims against the
16 bonds it had issued for Interworks in an amount thought to be in
17 excess of \$650,000.

18 As a provider of surety bonds in connection with
19 Interworks' public improvement contracts, Colonial is a
20 beneficiary of the Article 3-A trust funds that arise from
21 payments made pursuant to those contracts. If those funds are
22 diverted, Colonial is entitled to recover the amount it is owed
23 from whomever diverted the funds, provided that such person was
24 on notice, at the time the funds were diverted, that the funds
25 were trust assets. N.Y. Lien Law §§ 77.1, 77.3(6).

1 In an effort to recoup its expenses and satisfy the
2 liabilities it incurred as a result of Interworks' default on its
3 public improvement contracts, Colonial brought suit against
4 Merchant in New York State Supreme Court in May 2003. Colonial
5 alleged that under Article 3-A, the funds Merchant received that
6 had been paid to Interworks under the public improvement
7 contracts were trust funds that Merchant, standing in Interworks'
8 place as fiduciary to the trust, was required to pay to trust
9 beneficiaries, and that instead of paying the beneficiaries of
10 the trust created by the public improvement contracts, Merchant
11 had in fact used the assets to satisfy Interworks' obligations to
12 Merchant arising from their separate financing agreement. See
13 Second Amended Compl. (filed Jan. 13, 2004) ¶¶ 28-74. Colonial,
14 as a beneficiary of the trust, sought to be recognized as an
15 authorized class representative of all beneficiaries of the
16 Article 3-A trust. The court allowed Colonial to join another
17 putative class representative, but held the motion in abeyance
18 pending the outcome of a further hearing on class certification.

19 For reasons that are not readily apparent from the
20 record, the United States did not seek to intervene in this state
21 court action in an attempt to collect the unpaid employment taxes
22 that Merchant, standing in Interworks' place as a result of the
23 financing agreement between the two parties, owed on work
24 stemming from the public improvement contracts.

25 Interworks' Federal Lawsuit and the
26 United States' Complaint-in-Intervention

1 In July 2005, Interworks brought a parallel suit under
2 Article 3-A against Merchant in the United States District Court
3 for the Southern District of New York -- the instant action --
4 seeking, among other things, the same relief Colonial sought in
5 the New York State Court action. Interworks' complaint alleged
6 that the Article 3-A beneficiaries to the public improvement
7 contracts were required to be paid from the proceeds of
8 Interworks' accounts receivables, which the financing agreement
9 had placed in the custody and control of Merchant, and that
10 Merchant's failure to satisfy Interworks' obligations to the
11 Article 3-A trust fund beneficiaries amounted to a diversion of
12 trust-fund assets.

13 Unlike the lawsuit in New York Supreme Court, in which
14 the United States did not participate, the United States filed a
15 complaint-in-intervention in this federal suit. It asserted that
16 Merchant's failure to use trust-fund assets to satisfy the
17 \$557,129.29 or more that Interworks owed in employment taxes
18 violated Article 3-A.² The United States brought the complaint-
19 in-intervention in its own capacity, rather than as a
20 representative of all Article 3-A beneficiaries.

21 The case was transferred from the Southern District to
22 the Eastern District of New York in April 2006. In November

² The United States also named Colonial as a defendant for the sole purpose of establishing its relative priority of recovery should liability be found against Merchant. Colonial cross-claimed against Merchant under Article 3-A, relying on the same arguments it made in its New York action.

1 2007, the Eastern District court dismissed the underlying
2 complaint with prejudice after Interworks indicated its intent to
3 voluntarily discontinue the action³ and failed to respond to an
4 order to show cause. This left the issues raised in the United
5 States' complaint-in-intervention and the cross-claims by
6 Colonial as the only surviving issues for the district court's
7 consideration.

8 Colonial and Merchant then jointly moved to dismiss the
9 United States' complaint-in-intervention on the grounds that the
10 United States had failed to comply with two procedural
11 requirements of Article 3-A suits: (1) that there be no prior
12 pending Article 3-A action, and (2) that such suits be brought in
13 a representative capacity. Without denying that these
14 requirements were provided for by statute and had not been
15 satisfied, the government opposed the motion to dismiss on the
16 grounds that Article 3-A does not apply to the United States and
17 that, even if it did, the United States' power to enforce federal
18 tax law in federal court either exempts it from compliance with
19 or preempts the procedural requirements of Article 3-A.

20 The district court, finding the government to be in
21 procedural default, granted the motion to dismiss. Interworks,
22 531 F. Supp. 2d at 482. Based largely on the fact that the
23 United States had brought suit to enforce its Article 3-A rights

³ It appears that Interworks' Chapter 11 bankruptcy case was converted into a Chapter 7 proceeding, and the Chapter 7 trustee declined to pursue the instant action.

1 under New York law, rather than to enforce a tax lien under
2 federal law, the court rejected the government's argument that
3 federal statutes that provide federal courts with original
4 jurisdiction over actions brought to enforce the federal tax laws
5 excuse the government from compliance with Article 3-A's
6 procedural requirements. Id. at 481.

7 The government appeals.

8 **DISCUSSION**

9 Merchant's liability under Article 3-A for diversion of
10 trust funds is not in dispute on appeal. Nor does any party
11 contest the United States' standing as a beneficiary of the trust
12 to enforce its claim against Merchant for unpaid taxes, or the
13 United States' priority relative to Colonial in recovering the
14 diverted trust funds through a properly filed lawsuit.⁴ And the
15 government concedes that its claim was not brought in conformance
16 with the requirements set forth in Article 3-A.

17 The sole issue on appeal, then, is whether the United
18 States is excused from compliance with two Article 3-A procedural
19 requirements: (1) that a claimholder to an Article 3-A trust

⁴ Section 77 of the Lien Law sets from the order of priority among claimholders to the trust, giving first priority to claims for taxes, unemployment insurance, and other employment-related contributions. N.Y. Lien Law § 77.8(a). Colonial, as a completing surety to Interworks, is equitably subrogated to the same rights of Interworks in the contract and cannot satisfy its claims against Merchant until all 3-A trust beneficiaries are first satisfied. See Titan Indem., 135 F.3d at 834 ("It is perfectly clear that the rights of a surety in the trust proceeds do not trump those of the Article 3-A trust fund beneficiaries.").

1 bring a "representative action . . . for the benefit of all
2 beneficiaries of the trust," and (2) that "no other such action
3 [be] pending at the time of the commencement" of the Article 3-A
4 claim. N.Y. Lien Law §§ 77.1, 77.2. The government does not
5 contend that it complied with these requirements. It asserts
6 instead that its compliance is unnecessary. We conclude that
7 where the United States brings an action pursuant to Article 3-A,
8 it is bound by the procedural requirement that there be no prior
9 pending Article 3-A action. Because the United States
10 procedurally defaulted by not meeting this requirement, we
11 therefore affirm the judgment of the district court. We need not
12 decide whether the government was bound by, or should have been
13 granted leave to comply with, the representative capacity
14 requirement.

15 I. Standard of Review

16 We review a district court's decision to grant a motion
17 to dismiss for failure to state a claim upon which relief can be
18 granted de novo, taking the factual allegations in the complaint
19 to be true and drawing all reasonable inferences in the non-
20 movant's favor. City of New York v. Beretta U.S.A. Corp., 524
21 F.3d 384, 392 (2d Cir. 2008).

22 II. The "No Other Pending Action"
23 Requirement of Article 3-A

24 The United States did not intervene in Colonial's prior
25 Article 3-A state action. Instead, it intervened in the federal
26 action brought by Interworks two years after the action in New

1 York State Supreme Court had begun. The district court concluded
2 that this was improper under Article 3-A, which provides in
3 relevant part that "successive actions may be maintained from
4 time to time . . . provided no other such action is pending at
5 the time of the commencement thereof." N.Y. Lien Law § 77.2;
6 Interworks, 531 F. Supp. 2d at 481 ("[T]he United States is
7 subject to Article 3-A's prohibition against prior pending
8 actions when asserting its Article 3-A rights . . .").

9 The government does not contend that Colonial's prior
10 state court action was not a prior pending action for the
11 purposes of section 77.2; nor could it, see, e.g., Premier Elec.
12 Constr. Corp. v. Sec. Nat'l Bank of Long Island, 39 A.D.2d 967,
13 968, 334 N.Y.S.2d 199, 200 (2d Dep't 1972) (interpreting section
14 77.2 to apply to a subsequent action brought by "a new plaintiff
15 who could be said to be a member of the class which the plaintiff
16 bringing the first action intended to benefit."). Instead, the
17 United States offers three separate reasons why it should be
18 excused from compliance with Article 3-A's procedural
19 requirements: (1) Article 3-A does not apply to actions by the
20 United States; (2) even if Article 3-A applies to actions by the
21 United States, the United States has an unqualified right to
22 bring this action in federal court pursuant to its power to
23 enforce the federal tax code under 26 U.S.C. § 7402; and (3) to
24 the extent that Article 3-A conflicts with 26 U.S.C. § 7402,
25 Article 3-A is preempted.

26 A. Application of Article 3-A to the United States

1 The United States' first argument, relying primarily on
2 Leiter Minerals, Inc. v. United States, 352 U.S. 220 (1957), is
3 that Article 3-A does not apply to it because the statute lacks
4 express words so indicating. We implicitly rejected this
5 argument in United States v. Certified Indus., Inc., 361 F.2d
6 857, 862 (2d Cir. 1966), where we assumed that the United States
7 would be subject to Article 3-A's statute of limitations. We now
8 explicitly reject the argument, joining at least one district
9 court in our Circuit that has, in analyzing Article 3-A's
10 representative capacity requirement, found the statute's
11 procedural requirements to be applicable to the United States.
12 See Quantum Corporate Funding v. Bast Hatfield, Inc., No. 5:04-
13 cv-137, 2005 WL 1926610, at *6, 2005 U.S. Dist. LEXIS 14222, *18-
14 *23 (N.D.N.Y. June 8, 1995).

15 As support for its argument, the government cites to a
16 heavily qualified canon of statutory construction recognized in
17 Leiter, which it portrays as a rule of general and wide-ranging
18 applicability: that "'statutes which in general terms divest pre-
19 existing rights or privileges will not be applied to the
20 sovereign without express words to that effect.'" Leiter, 352
21 U.S. at 224 (quoting United States v. United Mine Workers, 330
22 U.S. 258, 272 (1947)). The canon is inapplicable to the facts of
23 this case. Article 3-A does not divest the United States of any
24 "pre-existing rights." The rights the United States seeks to
25 enforce are Article 3-A trust fund rights that are created by,
26 and do not exist apart from, the statute itself. These rights

1 therefore cannot be understood as "pre-existing," and the canon
2 therefore does not apply.⁵

3 The government argues that applying Article 3-A would
4 frustrate its power to collect federal taxes in federal court.
5 Appellant's Br. at 30. This argument fails because, as discussed
6 further below, an Article 3-A suit does not impede the
7 government's ability to bring an action to enforce taxes owed by
8 any party. See infra Part II(B). Even if the United States is
9 unsuccessful in its Article 3-A suit, it may still bring a tax
10 enforcement action against Merchant or any other party to collect
11 unpaid employment taxes that arose out of contracts at issue
12 here.

13 Article 3-A does create, subject to certain procedural
14 limitations, a right for some parties to act by lien or
15 foreclosure against these trust fund assets. It provides that
16 right to the United States, too. But the United States has no
17 pre-existing right to these specific assets because, to obtain
18 such a right, it must prevail in the Article 3-A suit, subject to
19 Article 3-A's limitations.

⁵ The Interworks district court distinguished Leiter on different grounds, viewing the holding as applicable only where the United States' position was defensive. See Interworks Sys., 531 F. Supp. 2d at 482 (citing United States v. Certified Indus., Inc., 361 F.2d 857, 860 n.2 (2d Cir. 1966)). Inasmuch as we conclude that Leiter does not render Article 3-A inapplicable to the United States because it did not divest the United States of pre-existing rights, we need not and do not address whether the district court's interpretation of Leiter was correct.

1 For this reason, we find that Article 3-A applies to
2 the United States.⁶

3 B. Supremacy of and Preemption by 26 U.S.C. § 7402

4 The government argues that even if Article 3-A is
5 applicable to the United States, it may nonetheless intervene in
6 this federal court action because Congress has elsewhere
7 manifested an intent to provide the United States with an
8 "unqualified right to have [such] case[s] heard in federal
9 court." Appellant's Br. at 23. It relies on 26 U.S.C. § 7402,
10 which vests the district courts of the United States with
11 jurisdiction to hear civil actions and to render such judgments
12 and decrees "as may be necessary or appropriate for the
13 enforcement of the internal revenue laws." 26 U.S.C. § 7402(a).
14 It points out that the statute provides that these remedies are
15 "in addition to and not exclusive of any and all other remedies

⁶ Although we do not rely on them, we note that there are other possible reasons that Leiter's canon of statutory construction probably does not apply here. For example, Leiter applies only to statutes that divest the United States of pre-existing rights "in general terms." Leiter, 352 U.S. at 224. We very much doubt that Article 3-A fits this description. See N.Y. Lien Law § 71.2(c) (providing that trust assets shall be used to satisfy the payment of employment taxes); id. § 77.8(a) (discussing the priority of tax authorities in relation to other beneficiaries of the trust).

And even if we were to apply Leiter's canon, the other statutory construction factors discussed in Leiter, see Leiter, 352 U.S. at 225-26 (looking to legislative intent, the purpose of the statute, a reading of the statute as a whole, and whether applying the canon would foreclose the ability of the United States to finally determine the basic issue in the litigation, in deciding whether to apply the canon), would support the district court's construction of Article 3-A, not that of the government.

1 of the United States in such courts or otherwise to enforce such
2 laws." Id.

3 At the heart of the government's argument is the
4 proposition that New York State Article 3-A and federal statute
5 26 U.S.C. § 7402 are in conflict, and that by being forced to
6 proceed in state court to assert its Article 3-A rights, the
7 government is impeded from asserting its right to collect taxes
8 in federal court. But the district court ruling did not inhibit
9 the United States' ability to bring a tax enforcement action in
10 federal court. The government may bring such an action to assert
11 its rights to tax, and to collect taxes against, Interworks,
12 Merchant, or any other party. The district court held only that
13 if the United States chose to bring an action under Article 3-A
14 of the New York Lien Law to enforce a right created by New York
15 statute against specific funds impressed by a state-created
16 trust, it was required to comply with the procedural requirements
17 of that state statute. See Interworks Sys., 531 F. Supp. 2d at
18 481-82.⁷

19 To be sure, the result of the district court ruling is
20 that the United States could not collect certain specific assets
21 of Merchant in federal court. But the ruling in no way impeded

⁷ The United State relies heavily on the argument that its action is in personam rather than in rem or quasi in rem. That question is irrelevant to this appeal. The distinction between in personam and in rem cases that the United States seeks to draw from Certified and Leiter related to whether an injunction against state court proceedings could issue, not whether the United States should be held to the procedural requirements of a state statute.

1 or otherwise had an impact on the ability of the United States to
2 litigate, in federal court, as to Merchant's legal obligations to
3 pay the federal taxes in question.

4 The government has conceded that this action is not an
5 action to enforce a tax lien. See Transcript of Pre-Motion
6 Conference, Interworks Sys. Inc. v. Merchant Fin. Corp., No. 06-
7 cv-1981 at 13 (S.D.N.Y. Nov. 29, 2007) (Counsel for United
8 States: "We're not seeking to enforce a lien."). Instead, the
9 government is seeking to establish a state-law-created right to
10 certain trust fund assets that would allow it to obtain a tax
11 lien. In other words, even if the United States has a right to
12 collect taxes from Merchant, it has no right to use these
13 specific trust-fund assets to satisfy Merchant's tax obligations
14 until it has prevailed in its Article 3-A suit. See Aquilino v.
15 United States, 363 U.S. 509, 513 (1960) (finding that state law
16 governs the nature of the legal interest in the property to be
17 taxed by the federal government).

18 We have recognized in the past that the United States
19 is not divested of any rights by being forced to proceed in state
20 court under Article 3-A. See Certified, 361 F.2d at 861-62.
21 Article 3-A facilitates rather than impairs the ability of the
22 United States to bring federal tax collection actions, by
23 designating first priority for distribution of trust assets to
24 "trust claims for taxes and for unemployment insurance and other
25 contributions, due by reason of employments, and for amounts of

1 taxes withheld or required to be withheld." N.Y. Lien Law §
2 77.8.

3 The cases on which the United States relies, such as
4 Markham v. Allen, 326 U.S. 490 (1946), do not require a contrary
5 result. They stand at most for the proposition that if the
6 United States seeks to enforce a federal right that is permitted
7 by statute to be litigated in federal court, then the United
8 States cannot be compelled to litigate in state court. See id.
9 at 495-96 (allowing a lawsuit to enforce rights under the Trading
10 with the Enemy Act to proceed in federal court, even though
11 resolution of the case required the federal court to make a
12 determination of rights to a decedent's estate that are within
13 the jurisdiction of state probate court). Here, however, the
14 United States is not seeking to enforce a federal right to
15 collect taxes. It is asserting a state right to be deemed a
16 beneficiary of a state-law-created trust.

17 For similar reasons, we reject the United States'
18 argument that the Supremacy Clause of the United States
19 Constitution, Art. VI, cl. 2, mandates that New York's Article 3-
20 A is preempted because it conflicts with 26 U.S.C. § 7402.
21 Appellant's Br. at 55-57. As explained above, Article 3-A is not
22 a tax statute and is not in conflict with 26 U.S.C. § 7402(a).
23 Resolution of the Article 3-A claim would not foreclose an action
24 to enforce the federal tax laws in district court under 26 U.S.C.
25 § 7402(a). Even if the United States were adjudicated not to be
26 a beneficiary under the Article 3-A trust to these trust fund

1 assets, this would not inhibit the United States from bringing an
2 action against Merchant to collect unpaid employment taxes
3 relating to these public employment contracts.

4 We will not conclude that a state statute was
5 "'superseded by [a] Federal Act unless that was the clear and
6 manifest purpose of Congress.'" Altria Group, Inc. v. Good, 129
7 S.Ct. 538, 543 (2008) (quoting Rice v. Santa Fe Elevator Corp.,
8 331 U.S. 218, 230 (1947)). Even when Congress expresses an
9 intent to preempt, if the statute can plausibly be read not to
10 preempt in an individual case, courts are to "'accept the reading
11 that disfavors pre-emption.'" Id. (quoting Bates v. Dow
12 Agrosciences LLC, 544 U.S. 431, 449 (2005)). Inasmuch as we
13 conclude that there is neither a conflict between Article 3-A and
14 the power to enforce federal tax laws, nor an intent by Congress
15 to preempt Article 3-A, a finding of federal preemption is not
16 warranted here.

17 III. The Representative Capacity Requirement
18 of Article 3-A

19 For the reasons that the "no pending action"
20 requirement applies to the United States, it would appear that
21 the United States is also bound by the "representative capacity"
22 requirement of Article 3-A, as the district court held. Inasmuch
23 as we affirm the district court's dismissal for lack of
24 compliance with the "no pending action" requirement, however, we
25 need not decide whether that is so or address whether the
26 district court committed error by refusing to allow the United

1 States to amend its complaint to conform with the representative
2 capacity requirement.

3 **CONCLUSION**

4 For the foregoing reasons, the judgment of the district
5 court is affirmed.